

viewpoint in Depreciation Simplification that a reserve ratio of 42% was satisfactory, then both reserve levels at both the federal and state level in 1994 would satisfy that benchmark.³² These trends indicate a similarity in the effects of both federal and state depreciation policy, with both leading to a rapid increase in depreciation reserves during the early 1990's.

Comparison of the Theoretical Reserve Deficit with the RBOCs' Write Downs

Several RBOCs have taken write-downs on their financial books to reflect alleged concerns that certain assets may have book values exceeding true market value because of inadequate past depreciation and regulation-imposed service lives that are unrealistically long. These RBOCs argue that the write-downs are necessary to warn investors of the likelihood that changing regulatory and market conditions may make it impossible for the RBOCs to fully recover their fixed investment. The RBOCs are not proposing write-downs or write-offs on their regulatory books, nor are they proposing to actually retire the "impaired" assets now. Nonetheless, it is interesting to compare the service lives from the RBOCs' financial statements with the service lives they proposed to the FCC in their most recent depreciation represcription. Tables 16, 17, 18, 19, and 20 show the comparisons for Ameritech, Bell Atlantic, BellSouth, NYNEX, and US West.

The service lives proposed to the FCC by three of the five RBOCs are very close to the service lives they list in their financial restatements, with the exception that the companies have

³²Simplification of the Depreciation Prescription Process, Report and Order, (1993), p. 8045, ft 86.

TABLE 16

**Comparison of Average Service Life Reported on Ameritech's Financial
Statements with its Company Proposals to FCC.**

Plant Account	Title	1994 AMERITECH ANNUAL REPORT	1995 AMERITECH COMPANY PROPOSALS	1994 AMERITECH COMPANY PROPOSALS	1992-94 AMERITECH COMPANY PROPOSALS
2212	Digital Switch	7	11.7	15.1	13.3
2232	Circuit Accounts	7	9.8	10.1	10.0
2421-6	Copper & Fiber Cable	15	19.7	20.2	20.5

Note: Average service life from company proposals is a weighted average over all Ameritech states, with investment (as of 1/1/94) as the weights. Ameritech states and the year of their company proposals are as follows: 1994 (IL), 1993 (OH), 1992 (IN, MI, WI). Copper and fiber cable includes the following plant accounts 2421, 2422, 2423, 2424, 2426 (but not 2425).

TABLE 17

**Comparison of Average Service Life Reported on Bell Atlantic's Financial
Statements with its Company Proposals to FCC.**

Plant Account	Title	1994 BELL ATLANTIC ANNUAL REPORT	1995 BELL ATLANTIC COMPANY PROPOSALS	1994 BELL ATLANTIC COMPANY PROPOSALS	1992-94 BELL ATLANTIC COMPANY PROPOSALS
2121	Buildings	18-40	39.7	41.9	40
2212	Digital Switch	12	13.3	13.0	14.1
2232	Digital Circuit	9-11	10.2	10.1	10.1
2441	Conduit	50	46.5	48.8	52.2
	Copper Cable	14-19	19.3	19.9	19.9
	Fiber Cable	20-25	18.6	21.0	21.0

Note: Average service life from company proposals is a weighted average over all Bell Atlantic states, with investment as the weights. Bell Atlantic states and the year of their company proposals are as follows: 1994 (NJ, DE), 1993 (VA, WV), 1992 (MD, DC, PA). Only NJ and DE separate copper from fiber in their cable plant accounts. Consequently, the copper and fiber numbers in the above table are for those two states only. Cable accounts 2421, 2422, 2423, & 2426 were used in the above table.

TABLE 18

**Comparison of Average Service Life Reported on BellSouth's Financial
Statements with its Company Proposals to FCC.**

Plant Account	Title	1995 BELLSOUTH PRESS RELEASE	1995 BELLSOUTH COMPANY PROPOSALS	1993 BELLSOUTH COMPANY PROPOSALS	1992-93 BELLSOUTH COMPANY PROPOSALS
2212	Digital Switching	10	9.7	14.1	12.4
2232	Circuit—Other	9.1	9.1	9.0	8.9
2421	Aerial Metallic Cable	14	14.5	16.2	15.6
2422	Underground Metallic Cable	12	16.5	17.4	17.0
2423	Buried Metallic Cable	14	14.5	16.6	15.9

Note: Average service life from company proposals is a weighted average over all BellSouth states, with investment (as of 1/1/94) as the weights. BellSouth states and the year of their company proposals are as follows: 1993 (AL,KY,LA,MS,TN), 1992 (FL,GA,NC,SC). No BellSouth states were represented in 1994.

TABLE 19

**Comparison of Average Service Life Reported on NYNEX's Financial
Statements with its Company Proposals to FCC.**

Plant Account	Title	1995 NYNEX PRESS RELEASE	1995 NYNEX COMPANY PROPOSALS	1994 NYNEX COMPANY PROPOSALS
2212	Digital Switching	12	13.9	12.5
2232	Circuit-Other	8	10.2	10.3
2421	Aerial Metallic Cable	17	17.9	16.7
2422	Underground Metallic Cable	15	25.3	15.4
2423	Buried Metallic Cable	17	19.7	19.3
	Fiber	20	19.4	22.6

Note: Average service life from company proposals is a weighted average over all NYNEX states, with investment as the weights. NYNEX states and the year of their company proposals are as follows: 1995 (NY), 1994 (ME,MA,NH,RI,VT). The company proposals for 1994 were included in NYNEX's 1994 Theoretical Reserve Study submission to the FCC. The category, Fiber, encompasses plant accounts 2421, 2422, 2423, 2424, & 2426.

TABLE 20

**Comparison of Average Service Life Reported on US West's Financial
Statements with its Company Proposals to FCC.**

Plant Account	Title	1993 US WEST ANNUAL REPORT	1995 US WEST COMPANY PROPOSALS	1994 US WEST COMPANY PROPOSALS	1992-94 US WEST COMPANY PROPOSALS
2121	Buildings	27-49	37.7	37.4	39.1
2124	General Purpose Computers	6	6.4	6.1	5.9
2212	Digital Switch	10	9.1	9.1	11.2
2232	Digital Circuit	10	9.6	9.9	9.9
2421	Aerial Copper Cable	15	15.9	16.0	17.3
2422	Underground Copper Cable	15	19.3	17.4	20.1
2423	Buried Copper Cable	20	21.4	19.7	22.0
	Fiber Cable	30	16.5	17.0	20.1

Note: Average service life from company proposals is a weighted average over all US West states, with investment as the weights. US West states and the year of their company proposals are as follows: 1994 (AZ, CO, NM, UT, WY), 1993 (ID, MT, OR, WA), 1992 (IA, MN, NB, ND, SD). Fiber includes the accounts 2421, 22, 23, 24, & 26.

apparently not proposed to the FCC service lives for metallic cable as short as in their financial restatements. There are two exceptions to this general rule: NYNEX in New York and Ameritech. NYNEX in New York has proposed considerably longer lives for both underground metallic cable and digital switching than the service lives it has proposed in other states (see Table 19). Although the proposed service lives for other NYNEX states are not that different from the service lives listed in NYNEX's financial statements, the NYNEX--New York service lives are considerably higher. Moreover, NYNEX--New York's proposed service lives for digital switching and underground cable are the highest of the five RBOCs, with the exception of Ameritech for digital switching. Ameritech's service lives in the financial restatements are substantially shorter than they have proposed to the FCC, and they are also far shorter than the lives proposed for financial restatement and FCC purposes by the other five RBOCs. Thus the change in depreciable asset lives claimed by the RBOCs when restating their financial books are (more often than not) consistent with the service lives they have proposed to the FCC. There is certainly no consistent support in these restatements for shorter asset lives than the RBOCs are proposing to the FCC. Ameritech is the outlier, and its financial statement provides no explanation for why its proposed service lives are so different from its own proposals to the FCC and from the service lives used by the other RBOCs for financial restatement.

Conclusion

RBOC complaints about inappropriate regulatory depreciation policies are grossly overstated. From the standpoint of "fairness" to the LECs, rates based on economic cost (which are substantially below current rates by as much as \$138 per line per year)³³ would only have to be supplemented by a very small adjustment (\$11-12 per line annually over 5 years, if done with a special amortization) to account for possible underdepreciation.³⁴ Moreover, underdepreciation does not provide a rationale for universal service taxes on new entrants to local telephone service. Finally, the RBOCs' profits are not overstated due to regulators' depreciation policies.

The vast majority of the small difference between RBOC-based and FCC-based estimates of the reserve deficit appears to be due to different assumptions about appropriate retirement of subscriber metallic cable. To the extent such replacement is not necessary for basic local and access service, no additional depreciation expense should be included in the stand-alone cost and price of those services. The FCC's reserve deficit is roughly 33-50% accounted for by subscriber

³³ The SPR study estimates that toll and access revenues are priced \$20 billion above cost. The Hatfield Associates' estimate of universal service cost, \$4 billion, should be subtracted from this figure to obtain the actual amount by which overpricing of these LEC services is not contributing to a subsidy necessary for universal service. The resulting \$16 billion figure amounts to \$138/year on a per subscriber basis.

³⁴ Adding the FCC's 1994 reserve deficit of \$3.2 billion to the \$3.0 billion adjustment for state depreciation reserves yields a combined total of \$6.2 billion to be recovered. On a five year amortization, that amounts to \$1.24 billion per year. The RBOCs have a total of 115,281,227 access lines, so the annual amount per line is \$10.76. If one does the same calculation based on the FCC-based reserve deficit for 1995, the annual charge per line would be about \$12.40. To get this number, the FCC-based reserve deficit (\$2.07 billion) for the RBOC operations prescribed in 1995 was doubled, since those operations accounted for about one-half the RBOCs' total gross plant.

metallic cable. To the extent that recent RBOC retirements or planned retirements of subscriber metallic cable are motivated by a desire to provide non-basic services, the FCC's reserve deficit will be too high. That is, the deficit would then be partially based on retirements or planned retirements that would not be undertaken by a company providing only traditional basic services. Thus, basing the reserve deficiency on the FCC's prescribed parameters may overstate the true adjustment necessary to correct for underdepreciation of subscriber metallic cable in the past. Since the bulk of the RBOCs' claim for a higher reserve deficit appears accounted for by subscriber metallic cable, there is little reason to increase the depreciation deficiency for a stand alone, economically efficient, basic local telephone company. This is not to say that the RBOCs should not be allowed to replace subscriber metallic cable. They should be free to replace metal with fiber cable so long as the price of local and access service remains based on the costs of the stand-alone network without such replacements. At least one RBOC is candid that such a constraint may well make the investment uneconomic. It appears, then, that only by increasing basic local service prices can the investment be recovered.³⁵

³⁵See Reply of Bell Atlantic, Transmittal No. 741, In the Matter of The Bell Atlantic Telephone Companies Tariff FCC No. 10, Video Dialtone Service, March 6, 1995, pp. 10-11.

STATEMENT OF QUALIFICATIONS

MicRA -- Microeconomic Consulting & Research Associates, Incorporated -- was founded in 1991 to provide high quality economic analysis and testimony for clients involved in litigation, and to conduct research on antitrust, regulatory, and other public policy issues. The principals at MicRA have held senior positions in both government and academia, and have many years of practical experience in business, consulting, and as expert witnesses. MicRA's economists have extensive experience analyzing economic issues specific to regulated industries, having advised government and private clients on issues in the telecommunications, broadcasting and cable television, pipeline, electric utility, natural gas, and railroad industries.

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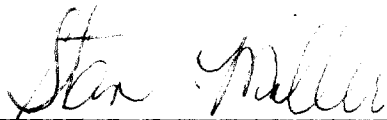
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